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Supreme Court of the United States

QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Petitioners,

v.

DENNIS E. ALFORD; JOAN R. GOWELL; TED G. BRITTON; JERRY L. HAMSTRA; LORI L. BREWER; RUSSELL H. HARTMAN; ROBERT D. RICHTER; MARY L. HILT; TIMOTHY D. MCLAUGHLIN; ROGER B. ROSENFELD, ET AL.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

ROBERT S. HERTZBERG
MICHAEL H. REED
PEPPER HAMILTON LLP
100 RENAISSANCE CENTER,
SUITE 3600
DETROIT, MI 48243
TELEPHONE: (313) 259-7110
FACSIMILE: (313) 259-7926

COUNSEL FOR THE PETITIONERS

JOHN K. CUNNINGHAM
[*COUNSEL OF RECORD*]
RAOUL G. CANTERO
DAVID P. DRAIGH
GLENN M. KURTZ
WHITE & CASE LLP
1155 AVENUE OF THE AMERICAS
NEW YORK, NY 10036-2787
TELEPHONE: (212) 819-8200
FACSIMILE: (212) 354-8113

COUNSEL FOR THE PETITIONERS

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

This case presents two questions important to the administration of bankruptcy cases, and on both issues the federal courts are in conflict. In the bankruptcy of Quality Stores, Inc. and affiliated debtors, the bankruptcy court prevented the Debtors from recovering otherwise avoidable prepetition transfers, specifically $111.5 million in cash payments made in a private leveraged buyout transaction. The bankruptcy court applied 11 U.S.C. § 546(e), which provides, in part, that a trustee may not avoid a "settlement payment . . . made by or to a . . . financial institution . . . that is made before the commencement of the case." The Bankruptcy Code defines "settlement payment"—circularly, as courts on both sides have recognized—as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade[.]" The district and circuit courts affirmed. The two questions presented are:

(1) Whether section 546(e) prevents a trustee from recovering otherwise avoidable prepetition transfers solely because the funds passed through a financial institution that had no dominion or control over the funds?

(2) Whether a payment made in a purely private securities transaction is a "settlement payment" exempt from avoidance, even though both the statutory definition (requiring such payments to be "commonly used in the securities trade") and the legislative history of the provision show that the term applies only to public transactions?

PARTIES TO THE PROCEEDING BELOW

The case caption contains the names of all parties who were parties in the court of appeals.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of this Court's Rules, petitioners state as follows:

Quality Stores, Inc. is wholly owned by QSI Holdings, Inc., and, in turn, the stock of QSI Holdings, Inc., is held by a trust that was established pursuant to the Debtors' confirmed chapter 11 plan of reorganization. No parent or publicly held company owns 10% or more of the stock of QSI Holdings, Inc., and/or Quality Stores, Inc.

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IN THE

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No. 09-

QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Petitioners,

v.

DENNIS E. ALFORD; JOAN R. GOWELL; TED G. BRITTON; JERRY L. HAMSTRA; LORI L. BREWER; RUSSELL H. HARTMAN; ROBERT D. RICHTER; MARY L. HILT; TIMOTHY D. MCLAUGHLIN; ROGER B. ROSENFELD, ET AL.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

The Petitioners respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. 3a-13a) is reported at 571 F.3d 545. The opinion of the district court

affirming the bankruptcy court's opinion (App. 15a-35a) is reported at 382 B.R. 731. The bankruptcy court's opinion (App. 38a-50a) is reported at 355 B.R. 629.

JURISDICTION

The judgment of the court of appeals was entered on July 6, 2009. (App. 2a) This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent text of 11 U.S.C. §§ 544, 546, 550 and 741(8) is set forth in the Appendix. (App. 51a-56a)

STATEMENT OF THE CASE

The Petitioners, each of them debtors (the "Debtors"), operated a chain of retail stores specializing in agricultural and related products. One of them, Quality Stores, Inc. ("Quality Stores"), was a privately held corporation that, in 1999, entered into an Agreement and Plan of Reorganization (the "Merger Agreement") with Central Tractor & Farm Country, Inc. ("Central Tractor"), and its acquisition vehicle, CT Holdings, Inc. ("CT Holdings," and collectively with Central Tractor, the "CT Parties"). (App. 5a)

Pursuant to the Merger Agreement, Quality Stores was to merge with and into Central Tractor, with the surviving entity changing its name to Quality Stores, Inc. (App. 5a) The transaction was structured as a leveraged buyout ("LBO") of Quality Stores by the CT Parties, and the Merger Agreement provided for Quality Stores' shareholders to be paid, in cash or stock, for their respective equity interests. (App. 5a-6a) The former shareholders of Quality Stores

(collectively the "LBO Recipients"), are the Respondents in this action. The total consideration for the Quality Stores LBO was about $208 million. (App. 6a) In exchange for their Quality Stores shares, the LBO Recipients received $91.8 million of stock in CT Holdings and $111.5 million in cash. (App. 6a)

To facilitate the transaction, CT Holdings hired HSBC Bank USA ("HSBC") to act as an exchange agent with respect to the surrender of certificates evidencing Quality Stores shares. (App. 41a) Accordingly, the CT Parties sent cash to HSBC with explicit directions on how it should be disbursed to the LBO Recipients when they surrendered their shares. (App. 6a) At no point did HSBC obtain dominion or control over such funds. Rather, HSBC was expressly an agent for CT Holdings. (App. 41a)

Following the transaction, Quality Stores suffered severe financial and liquidity problems, and a group of petitioning creditors filed an involuntary bankruptcy petition against it. In response, the Petitioners filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the United States Bankruptcy Court for the Western District of Michigan.

In the bankruptcy court, the Petitioners brought an adversary proceeding (the "Adversary Proceeding") to recover the $111.5 million in cash payments made to the LBO Recipients (the "LBO Payments"). After the bankruptcy court confirmed the Debtors' chapter 11 plan, the Debtors filed their initial complaint, later amended (the "Complaint"), against the LBO Recipients.

The Complaint alleges that, when they tendered their Quality Stores stock for cash, the LBO Recipients gave less

than reasonably equivalent value, and that the transaction left Quality Stores insolvent or with unreasonably small capital, and caused it to incur debts beyond its ability to pay. Accordingly, the LBO Payments are constructively fraudulent transfers avoidable by the Debtors under sections 544(b) and 550 of the Bankruptcy Code and the Michigan Uniform Fraudulent Transfer Act.

Certain LBO Recipients moved for summary judgment, arguing that the LBO Payments are exempt from avoidance because they are a "settlement payment . . . made by or to a . . . financial institution" under section 546(e). On October 26, 2006, the bankruptcy court granted those motions, notwithstanding that the financial institution involved (HSBC) never acquired any beneficial interest in the funds. The bankruptcy court entered its order on October 26, 2006. *QSI Holdings, Inc. v. Alford, et al. (In re Quality Stores, Inc.)*, 355 B.R. 629, 636 (Bankr. W.D. Mich. 2006) (App. 38a-50a). The Debtors timely appealed on November 27, 2006 to the United States District Court for the Western District of Michigan.

On December 21, 2007, the district court affirmed the bankruptcy court's order. *QSI Holdings, Inc. v. Alford, et al. (In re Quality Stores, Inc.)*, 382 B.R. 731, 743 (W.D. Mich. 2007) (App. 15a-35a). On January 18, 2008, the Debtors timely appealed to the United States Court of Appeals for the Sixth Circuit. On July 6, 2009, the Sixth Circuit affirmed. *QSI Holdings, Inc. v. Alford, et al. (In re Quality Stores, Inc.)*, 571 F.3d 545 (6th Cir. 2009) (App. 3a-13a)

REASONS FOR GRANTING THE PETITION

As explained below, this Court should grant review: (I) to resolve a conflict among the circuits as to whether section 546(e) prevents a trustee from recovering otherwise avoidable prepetition transfers solely because the funds passed through a financial institution; and (II) to resolve a conflict among the federal courts as to whether a payment made in a purely private securities transaction is a "settlement payment" exempt from avoidance under section 546(e). If left unreviewed, the decisions below will continue to cause substantial confusion in the administration of bankruptcy cases in the United States at a time when, given the current global financial crisis, certainty under this Nation's insolvency regime is most vital.

I. THE COURT SHOULD GRANT REVIEW TO RESOLVE A CONFLICT AMONG THE CIRCUITS AS TO WHETHER SECTION 546(e) PREVENTS TRUSTEES FROM RECOVERING OTHERWISE AVOIDABLE PREPETITION TRANSFERS SOLELY BECAUSE THE FUNDS PASSED THROUGH A FINANCIAL INSTITUTION

Every state has fraudulent transfer laws. These laws allow creditors to recover certain payments made to third parties before a debtor's insolvency for less than reasonably equivalent value, either while the debtor was insolvent or when the transaction renders the debtor insolvent or leaves it with unreasonably small capital. Bankruptcy trustees may use those laws or a comparable section of the Bankruptcy Code to avoid these types of transfers of the debtor's property. *See* 11 U.S.C. §§ 544(b), 548.

Because unwinding certain transactions may adversely affect national financial markets, however, Congress enacted

section 546(e) to "minimize the displacement caused in the commodities and securities market in the event of a major bankruptcy affecting those industries." *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 609 (11th Cir. 1996), *cert. denied, DFA Inv. Dimensions Group, Inc. v. Munford, Inc.*, 522 U.S. 1068 (1998). Section 546(e) is thus a limited exception to a trustee's avoidance power, providing, in relevant part:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case . . . .

11 U.S.C. § 546(e).[1]

Thus, by its express terms, section 546(e) "applies only to a 'transfer' made by or to one of the named entities." *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 195 B.R. 971, 981 (Bankr. D. Mass. 1996).

Applying a universally accepted doctrine developed under an adjacent provision of the Bankruptcy Code's avoidance scheme, the Eleventh Circuit has held that a financial institution that acts solely as an intermediary to a prepetition transfer among entities not named in section 546(e) is not a "transferee" of a debtor's property, and

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[1] All citations to the Bankruptcy Code herein do not reflect changes under Pub. L. No. 109-8, the Bankruptcy Abuse and Prevention Act of 2005, which are inapplicable in this case.

therefore, section 546(e) does not apply in such circumstances. *Munford*, 98 F.3d at 610.

Munford applied the "mere conduit" doctrine, a well-settled principle of fraudulent transfer law developed under section 550 of the Bankruptcy Code. That section, titled "Liability of transferee of avoided transfer," provides, in part, that "the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from . . . the initial transferee of such transfer or the entity for whose benefit such transfer was made." 11 U.S.C. § 550(a)(1).

Thus, like section 546(e)—which, "[b]y its own terms, . . . applies only to 'a transfer,'" *Healthco.*, 195 B.R. at 981—analysis under section 550 depends on the presence of a "transfer" and the meaning of "transferee." The construction of those terms has been a crucial issue under section 550 because, after a court avoids a transfer, trustees often attempt to recover the transferred property from a financial institution, even if the institution played only a limited role in the transfer. Acknowledging that it is inequitable to allow recovery from a financial institution that was merely an intermediary, courts have developed the "mere conduit" doctrine, which prohibits recovery of transfers from a financial institution unless it had "dominion" over the funds. *See, e.g.*, *Taunt v. Hurtado (In re Hurtado)*, 342 F.3d 528, 533 (6th Cir. 2003) ("An initial transferee must have 'dominion' over the funds to be an 'initial transferee' under [section 550].").

The question presented here, and on which the lower courts disagree, is whether section 546(e) prevents a trustee from recovering otherwise avoidable prepetition transfers solely because those transfers—by debtors to shareholders,

neither of which is exempt under section 546(e)—were processed through a financial institution that never had dominion or control over the transferred funds.

That question is highly important. Bankruptcy trustees commonly file avoidance actions to enhance the estate for the creditors' benefit, especially when the estate's most valuable asset is a cause of action to recover fraudulent transfers. Allowing section 546(e) to prohibit such avoidance actions solely because the transfers passed through a financial institution is contrary to fraudulent conveyance law, as well as to the fair treatment of unsecured creditors.

A. Courts Construing Section 546(e) Are Divided Over Whether That Provision Shields An LBO Recipient From An Avoidance Action Solely Because The Transfer Passed Through A Financial Institution

The Eleventh Circuit has held that section 546(e) does not apply to LBO payments because such payments are made *by* a debtor *to* a shareholder, neither of which is an entity exempted under section 546(e). On the other hand, the Third and Eighth Circuits, and the Sixth Circuit below, have held that, by virtue of being funneled through a financial institution, such payments are exempt from avoidance. That interpretation of section 546(e), however, is so broad that it allows debtors that have entered into prepetition LBOs to shield LBO payments, no matter how improper, from avoidance, simply by using a bank.

Indeed, the bankruptcy and district courts below, which followed the Third Circuit, both acknowledged that the Eleventh Circuit's construction of the statute is the fair one, *QSI Holdings*, 382 B.R. at 742; *QSI Holdings*, 355 B.R. at

635, and this Court should grant review to settle the conflict among the circuits.

1. The Eleventh Circuit Holds That Section 546(e) Does Not Apply Where A Financial Institution Is Merely A Transfer Agent

The circumstances in *Munford* are sharply analogous to those here. In *Munford*, the debtor agreed to be sold in an LBO, and the merger agreement provided that the funds used to purchase the company's outstanding stock would be deposited with Citizens & Southern Trust Company. *See* 98 F.3d at 607. After the sale of Munford, Inc. closed, Citizens duly made LBO payments to Munford's shareholders; thirteen months later, the post-sale Munford filed for bankruptcy. *Id.* at 607, 610.

The *Munford* debtors filed an adversary proceeding to recover those LBO payments. The shareholders responded that the payments were exempt from avoidance under section 546(e). *Id.* at 607-10. But the Eleventh Circuit held that "section 546(e) is not applicable *unless* the transfer . . . was 'made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency.'" *Id.* at 610 (citing 11 U.S.C. § 546(e)). (italics in original).

Because "the transfers/payments were made *by* Munford *to* shareholders," none of which are "entities listed in section 546(e)," the court held that "section 546(e) is not applicable." *Id.* at 610 (italics in original). The court held further that the result did not change simply because "a section 546(e) financial institution was presumptively involved in this transaction," given the court's finding that the "bank here was nothing more than an intermediary or conduit," and

"never acquired a beneficial interest in either the funds or the shares." *Id.* at 610.

The Eleventh Circuit reached that conclusion by applying the principles of the mere conduit doctrine, which, as described above, has been developed under the adjacent Code section 550, governing the liability of a transferee of an avoided transfer. Citing section 550, the court noted that, "[i]mportantly, a trustee may only avoid a transfer to a 'transferee,'" and concluded that the bank, because it "never acquired a beneficial interest in the funds, . . . was not a 'transferee' in the LBO transaction." *Id.* (citing 11 U.S.C. § 550; *Nordberg v. Societe Generale* (*In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1200 (11th Cir. 1988) ("When banks receive money for the sole purpose of depositing it into a customer's account . . . the bank never has actual control of the funds and is not a § 550 transferee.")). Instead, the transferees were the shareholders who received the LBO payments, and section 546(e) does not exempt shareholders. *Id.* at 610.

2. The Third And Eighth Circuits, And The Sixth Circuit Below, Have Held That Section 546(e) Is An Exception To The Avoidance Of Transfers Even Where A Financial Institution Is A Mere Conduit

In contrast to the Eleventh Circuit, the Third and Eighth Circuits have held that section 546(e) immunizes prepetition payments—even if the financial institution involved was only a conduit and never obtained any beneficial interest—merely because the payment was "made 'by or to a . . . financial institution.'" *See Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009); *Lowenschuss v. Resorts Int'l,*

Inc. (In re Resorts Int'l, Inc.), 181 F.3d 505, 516 (3d Cir. 1999) (same).

Although they acknowledged *Munford*'s analysis of "transfer" and "transferee" as those terms appear in sections 546(e) and 550, the Third and Eighth Circuits ignored both terms. Instead, they disagreed with *Munford* and held that prepetition LBO payments funneled through a bank were exempt under section 546(e) because that section "protects settlement payments 'made by or to a . . . financial institution,' and does not expressly require that the financial institution obtain a beneficial interest in the funds." *Contemporary Indus.*, 564 F.3d at 987; *see also Resorts Int'l*, 181 F.3d at 515-16 ("Section 546(e) protects . . . settlement payments made 'by . . . a financial institution.'").

The Sixth Circuit below, relying heavily on *Contemporary Indus.*, reached the same result, holding that the presence of the escrow agent, HSBC, "was sufficient to satisfy the requirement that the transfer was made to a financial institution." *QSI Holdings*, 571 F.3d at 551.

B. The Court Should Grant Review To Resolve The Conflict And To Articulate A Rule That Gives A Consistent Meaning To A "Transfer" Throughout The Bankruptcy Code's Avoidance Provisions

As noted above, section 546(e) expressly applies to "a transfer." 11 U.S.C. § 546(e). Thus, resolving this issue is essential so that the terms "transfer" and "transferee" are applied consistently throughout the avoidance provisions of the Bankruptcy Code.

Following well-settled principles of statutory construction, the *Munford* court interpreted the term

"transfer" in section 546(e) consistently with the universally accepted interpretation of the same term in section 550(a). Consistency is important because both sections are a part of a single statutory scheme—indeed, they are part of an interdependent series of statutes dealing with the avoidance and recovery of prepetition transfers—and this Court has held that there is a presumption in the Bankruptcy Code that "equivalent words have equivalent meaning when repeated in the same statute." *Cohen v. de la Cruz*, 523 U.S. 213, 220 (1998) (citation omitted); *see also Patterson v. Shumate*, 504 U.S. 753, 758 n.2 (1992) (citing *Morrison-Knudsen Constr. Co. v. Director, Office of Workers' Comp. Programs*, 461 U.S. 624, 633 (1983)) ("a word is presumed to have the same meaning in all subsections of the same statute").

The Third, Sixth, and Eighth Circuits' construction of Section 546(e) is contrary to the widespread adoption and application of the mere conduit doctrine, including by the Sixth and Eighth Circuits themselves, and by district courts within those circuits. Indeed, the Eighth Circuit has noted that "[a]t least seven other circuits have held that, to be an initial transferee, a party must have dominion and control over the transferred funds." *Luker v. Reeves (In re Reeves)*, 65 F.3d 670, 676 (8th Cir. 1995). *See also Hurtado*, 342 F.3d at 533 ("An initial transferee must have 'dominion' over the funds to be an 'initial transferee' under [section 550]."); *First Nat'l Bank of Barnesville v. Rafoth (In re Baker & Getty Fin. Servs., Inc.)*, 974 F.2d 712, 722 (6th Cir. 1992) ("An initial transferee is one who receives money from a person or entity later in bankruptcy, and has dominion over the funds."). The *Luker* court "approve[d] of this standard," and held that an unknowing recipient of funds was not an initial transferee under section 550 because it did not "receive[] any benefit from" the funds. *Luker*, 65 F.3d at 676. *See also*

Official Comm. of Unsecured Creditors v. Guardian Ins. 401 (In re Parcel Consultants, Inc.), 287 B.R. 41, 47 (Bankr. D.N.J. 2002) (holding that an investment vehicle for a 401(k) plan was not an initial transferee because it was "bound by . . . contract terms" that granted control of the funds to individual employees); *Broadway Advisors, LLC v. HIPRO Electronics, Inc. (In re Gruppo Antico, Inc.)*, 359 B.R. 578, 587 (Bankr. D. Del. 2007) (noting that an affiliate of a transferee was not an initial transferee under section 550 because it merely conveyed funds to the initial transferee).

As the Eighth Circuit recognized, the vast majority of circuits have adopted and applied the "mere conduit" doctrine. *See In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey*, 130 F.3d 52, 58 (2d. Cir. 1997) (holding that an insurance broker was not an "initial transferee" because it acted as mere conduit for transfers of premiums and had no authority or discretion to do anything but transmit funds); *Malloy v. Citizens Bank of Sapulpa (In re First Sec. Mortgage Co.)*, 33 F.3d 42, 44 (10th Cir. 1994) (holding that a bank was not an initial transferee because it held funds "only for the purpose of fulfilling an instruction to make the funds available to someone else") (citation and quotation marks omitted); *Sec. First Nat'l Bank v. Brunson (In re Coutee)*, 984 F.2d 138, 141 (5th Cir. 1993) (holding that a law firm was not an initial transferee where it held funds in a trust account for a client); *Danning v. Miller (In re Bullion Reserve of N.A.)*, 922 F.2d 544, 548-49 (9th Cir. 1991) (where the recipient of money had a contractual obligation to immediately transfer funds, he was not an initial transferee even though the funds were eventually spent for his benefit); *Nordberg*, 848 F.2d at 1200 (observing that "[w]hen trustees seek recovery of allegedly fraudulent conveyances from banks, the outcome of the cases

turn on whether the banks actually controlled the funds or merely served as conduits"); *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988) (holding that a bank, which received a check from a debtor that was payable to the bank's order but with instructions to deposit the check in a depositor's account, was not an initial transferee because the bank received no benefit from the transfer).

As a result, in the Eleventh Circuit, the terms "transfer" and "transferee" mean the same thing in section 550 and section 546(e); while in the Third, Sixth, and Eighth circuits, they mean one thing in one statute but something else in the other. This Court should grant certiorari to resolve the conflict and to preserve the integrity of the Bankruptcy Code's avoidance provisions.

II. THE COURT SHOULD GRANT REVIEW TO RESOLVE A CONFLICT AMONG THE FEDERAL COURTS AS TO WHETHER PREPETITION LBO PAYMENTS IN PURELY PRIVATE TRANSACTIONS ARE "SETTLEMENT PAYMENTS" UNDER SECTION 546(e)

As shown above, section 546(e) expressly applies only to a "settlement payment, as defined in section . . . 741" of the Bankruptcy Code. 11 U.S.C. § 546(e). Section 741 provides that:

> "settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, *or any other similar payment commonly used in the securities trade[.]*"

11 U.S.C. § 741(8) (emphasis added).

Numerous courts have recognized that this definition is somewhat "circular," *e.g.*, *Healthco.*, 195 B.R. at 983, but that it "is saved from complete circularity by the concluding phrase, 'or any other similar payment commonly used in the securities trade.'" *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68, 76 (Bankr. E.D.N.Y. 2007) (citing 11 U.S.C. § 741(8)). Indeed, without that "modifying language, . . . the statutory definition contained in § 741(8) would be, in effect, a meaningless tautology." *Id.*

Applying the "cardinal principle of statutory construction that a statute ought . . . to be so construed that . . . no clause, sentence, or word shall be superfluous," *Norstan* held that "the modifying phrase at the end of § 741(8) must be understood, at a minimum, to mean that in order to be encompassed in the statutory definition of 'settlement payment,' a transaction must involve the public securities markets," because the "'securities trade' in this statutory context plainly means the public securities markets." *Id.*

Although courts "agree that the § 546(e) definition of 'settlement payment' is to be read broadly, the term 'is not boundless.'" *Jackson v. Mishkin (In re Adler, Coleman Clearing Corp.)*, 263 B.R. 406, 478 (S.D.N.Y. 2001) (quoting *In re Kaiser Merger Litig.*, 168 B.R. 991, 1001 (D. Colo. 1994)). Moreover, as this Court has held, the plain meaning of a statute should control, "except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)).

Such is the case here, where the legislative history of section 546(e) makes plain that Congress enacted that statute for the sole purpose of protecting the nation's financial markets from instability. In 1978, Congress enacted the predecessor to section 546(e)—which applied only to commodities markets—to "promote customer confidence in commodity markets generally" through "the protection of commodity market stability." *Kaiser Steel Corp. v. Charles Schwab & Co., Inc.*, 913 F.2d 846, 848-49 n.3 (10th Cir. 1990) (citing S. Rep. No. 989, 95th Cong., 2d Sess. 8 (1978)). In 1982, Congress replaced section 764(c) with section 546(e) and sections 741(5) and (8) "to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market." *Id.* at 849 (citing H.R. Rep. No. 420, 97th Cong., 2d Sess. 2 (1982)).

Congress's purpose in enacting new section 546(e) was "to minimize the displacement caused in the commodities and securities markets in the event [of] a major bankruptcy affecting those industries," and "to prevent the 'ripple effect' created by 'the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected industry.'" *See Adler*, 263 B.R. at 477 (quoting H. Rep. No. 97-420, at 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583); *see also, e.g., Norstan*, 367 B.R. at 76; *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 533 n.6 (B.A.P. 9th Cir. 2005) (same); *see also Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1237-38 (10th Cir. 1991) [hereinafter *Kaiser II*] (describing complex system of guarantees used in public markets, which section 546(e) was designed to protect).

Accordingly, courts have held that extending the reach of section 546(e) to private transactions would be inconsistent with Congress's statutory scheme. For example, in *Jewel Recovery, L.P. v. Gordon*, 196 B.R. 348, 352 (N.D. Tex. 1996) (citations omitted), the court held that, in enacting chapter 5 of the Bankruptcy Code, "Congress determined that a few individuals should not be allowed to benefit from transfers by an insolvent entity at the expense of the many. Rather, Congress intended equal shares of the bankruptcy estate for creditors of equal rank." But, as the court held, extending the reach of section 546(e) beyond public markets would eviscerate other sections of chapter 5 without any legitimate purpose:

> The affirmative application of § 546(e) to this transaction would serve to sanction the practice of structuring private stock purchases in an effort to circumvent the avoidance section, merely by utilizing a financial institution. Private transactions lack the impact on the public market trading systems that Congress intended to protect by § 546(e). Accordingly, applying the plain language of § 546(e) to this private transaction conflicts and is inconsistent with Congress' statutory scheme in Chapter 5 of the Code.

Id. at 353.

Other federal courts, however, have extended the reach of section 546(e) to purely private transactions. Thus, the question presented here, and on which the courts disagree, is whether a payment made in a purely private transaction is a "settlement payment" exempt from avoidance, even though the statute and its legislative history show that the term applies only to public transactions.

The circuits are not so sharply in conflict on this question as they are on the applicability of the mere conduit doctrine to section 546(e). As shown below, however, there is a very clear split among numerous district and bankruptcy courts—and conflict among those courts and some circuits—and this Court has frequently granted certiorari in such situations. For example, in *Penn. Dept. of Pub. Welfare v. Davenport*, 495 U.S. 552, 557 (1990), *superseded by statute*, Pub. L. No. 101-647, 11 U.S.C. § 1328(a), the Court granted certiorari "[t]o address a conflict among Bankruptcy Courts." *See also Cohen*, 523 U.S. at 217 (granting certiorari, in part, because bankruptcy courts have "reached differing conclusions on whether § 523(a)(2)(A) prevents the discharge in bankruptcy of punitive damages awarded on account of fraud").[2]

A. The Federal Courts Disagree On Whether The Section 546(e) Exemption From Avoidance Applies To Purely Private Securities Transactions

As noted above, the courts agree that the definition of "settlement payment" in section 546(e) is broad but not

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[2] In addition, see *City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 257 n.14 (1981) (granting certiorari where the "issue has already arisen on several occasions" and citing four district court opinions); *Dawson Chem. Co. v. Rohm & Haas Co.*, 448 U.S. 176, 185 & n.4 (1980) (granting certiorari "to forestall a possible conflict in the lower courts" where there was "no direct conflict" but "some tension" among the circuits and district courts"); *Curtis v. Loether*, 415 U.S. 189, 191 n.2 (1974) (granting certiorari where only one circuit had decided the issue "but the reported decisions of the district courts are evenly divided"); *United States v. Constantine*, 296 U.S. 287, 290 (1935) (granting certiorari where there was no circuit conflict but "diverse decisions in the District Courts").

boundless. Several courts, after considering the statutory text and Congressional intent, have held that the term applies only to transactions in the public markets, but other courts, including the Sixth Circuit below, broaden the definition so that it reaches virtually any transaction handled by a bank.

1. Several Bankruptcy And District Courts Hold That "Settlement Payments" Must Be Limited To Public Securities Transactions

In *Norstan*, the bankruptcy court for the Eastern District of New York held that extending section 546(e) to private securities transactions would yield "anomalous results . . . not compelled by the statutory language," and that the term "securities trade," as used in the definition of "settlement payment," "must be understood to mean transactions in the public markets." *Norstan*, 367 B.R. at 77. Accordingly, the court held that LBO payments made to shareholders in a private prepetition transaction were not exempt from avoidance under section 546(e). *Id.*

Similarly, in *Jewel Recovery*, the court held that section 546(e) does not apply to private LBO payments because the legislative history shows that the statute was designed to protect public markets, and private transactions "lack the impact on the public market trading systems that Congress intended to protect by § 546(e)." *Jewel Recovery*, 196 B.R. at 352-53. Other courts have reached the same conclusion with respect to payments to shareholders in private LBO transactions. *See, e.g., Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 676-77 (D.R.I. 1998) (holding that "settlement payment" does not include LBO payments to shareholders, reasoning that private transactions lack the impact on the public market trading systems that Congress intended to protect by section 546(e)); *Wieboldt Stores, Inc. v.*

Schottenstein, 131 B.R. 655, 663-65 (N.D. Ill. 1991) (holding that "settlement payment" does not include LBO payments to shareholders, because private securities transactions have no effect on clearance or settlement process).

Additional courts have reached the same conclusion in analogous situations not involving public transactions. *See Crown Paper Co. v. Fort James Corp. (In re Crown Vantage, Inc.)*, 2006 WL 2348850, at *5 (N.D. Cal. Aug. 11, 2006) ("[a] transaction that does not occur on a 'public market' and does not 'involve the process of clearing trades' is not a 'settlement payment' within the meaning of §546(e)"); *Grafton Partners*, 321 B.R. at 539-40 (holding that $4 million payment to member of Ponzi scheme was not a "settlement payment" because the "transaction in question did not occur on a public market and did not involve the process of clearing trades"); *Official Comm. of Unsecured Creditors v. Asea Brown Boveri, Inc. (In re Grand Eagle Cos., Inc.)*, 288 B.R. 484, 493-94 (Bankr. N.D. Ohio 2003) (holding that the acquisition of an equity interest for cash did not involve a publicly-traded company and, thus, was not a settlement payment); *Buckley v. Goldman, Sachs & Co.*, 2005 WL 1206865, at *7 (D. Mass. May 20, 2005) (holding that Congress' interest in protecting the operation of the securities industry's clearance and settlement system—which it sought to accomplish by enacting section 546(e)—"[was] not furthered in any meaningful sense by bringing an LBO like the one at issue in this case under the exemption of [section] 546(e)").

2. Other Courts, As Well As Some Circuit Courts, Have Held That Section 546(e) Applies To Private Securities Transactions

In contrast to courts limiting the section 546(e) exemption to public securities transactions, courts in other circuits—including some circuit courts, such as the Sixth Circuit below—have held that the exemption also applies to private LBO transactions. *See Contemporary Indus.*, 564 F.3d at 985-87 (holding that LBO payments qualify as settlement payments and that section 546(e) is "not expressly limited to public securities transactions"); *Resorts Int'l*, 181 F.3d at 515-16 (holding that pre-petition LBO payments were settlement payments under section 546(e), because an LBO is a common securities transaction); *QSI Holdings*, 571 F.3d at 550 (holding that "nothing in the text of § 546(e) precludes its application to settlement payments involving privately held securities" in an LBO); *Official Comm. Of Unsecured Creditors v. Clark (In re Nat'l Forge Co.)*, 344 B.R. 340, 363-66 (W.D. Pa. 2006) (holding that stock redemption in a private LBO was a settlement payment under section 546(e)).

Other courts—although not explicitly addressing the public/private issue—have nevertheless applied the section 546 exemption to private securities transactions, including LBOs. *See Kaiser II*, 952 F.2d at 1237-40 (holding that an exchange of stock as consideration in an LBO constitutes a settlement payment for purposes of section 546(e)); *Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 388 B.R. 46, 48-49 (D. Del. 2008) (holding that pre-petition payments by chapter 7 debtor were "settlement payments" under section 546(e), and that "settlement payment" should not be limited to publicly traded securities); *Walsh v. Toledo Hosp. (In re Fin. Mgmt. Scis., Inc.)*, 261 B.R. 150, 154-56 (Bankr. W.D.

Pa. 2001) (holding that debtor's pre-petition purchase of securities was a settlement payment under section 546(c)).

B. The Court Should Grant Review To Prevent The Abuse Of Section 546(e) In Leveraged Buyout Transactions

As the bankruptcy court in this case observed, the application of section 546(e) to private securities transactions may be inconsistent with Congressional intent and could lead to abuse, and specifically to parties "funnel[ing] payments . . . through a financial institution" as a simple expedient to avoid fraudulent transfer liability. *See Quality Stores*, 355 B.R. at 634. Indeed, as a commentator recently observed about the bankruptcy court's decision, now law in the Sixth Circuit:

> The main lesson to be learned from *Quality Stores* is that proceeds from an LBO should be "funneled" through a financial institution as a "settlement payment" to increase the possibility the payments will be shielded from fraudulent transfer scrutiny.

Gregory G. Hesse, *Section 546(e) and the Return of the LBO*, 26 Am. Bankr. Inst. J. 22, 23 (Mar. 2007).

The bankruptcy court and the commentators underscore the critical issue before the Court, namely that the law of some circuits—contrary to statutory language and Congressional intent—creates the potential for widespread abuse of section 546(e) as a method of improperly elevating shareholder interests over creditor interests in leveraged buyout transactions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

October 5, 2009

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

[Filed: July 29, 2009]

No: 08-1176

In re: QUALITY STORES, INC., *et al*
Debtors.

QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Appellants,

v.

DENNIS E. ALFORD; JOAN R. GOWELL; TED G. BRITTON; JERRY L. HAMSTRA; LORI L. BREWER; RUSSELL H. HARTMAN; ROBERT D. RICHTER; MARY L. HILT; TIMOTHY D. MCLAUGHLIN; ROGER B. ROSENFELD, *et al*
Appellees.

MANDATE

Pursuant to the court's disposition that was filed 07/06/2009 the mandate for this case hereby issues today.

COSTS: NONE

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

[Filed: July 06, 2009]

No. 08-1176

In re: QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Debtors.

QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Plaintiffs-Appellants,

v.

DENNIS E. ALFORD, *et al.*,
Defendants-Appellees.

On Appeal from the United States District Court for the Western District of Michigan at Grand Rapids.

JUDGMENT

Before: NORRIS, COOK, and GRIFFIN, Circuit Judges.

THIS CAUSE was heard on the record from the district court and was argued by counsel.

IN CONSIDERATION WHEREOF, it is ORDERED that the judgment of the district court is AFFIRMED.

ENTERED BY ORDER OF THE COURT

/s/ Leonard Green
Leonard Green
Clerk

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 08-1176

In re: QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Debtors.

QSI HOLDINGS, INC.; QUALITY STORES, INC.,
Plaintiffs-Appellants,

v.

DENNIS E. ALFORD, *et al.*,
Defendants-Appellees.

Appeal from the United States District Court
for the Western District of Michigan
at Grand Rapids.

No. 06-00876-Janet T. Neff, District Judge.
Argued: March 4, 2009
Decided and Filed: July 6, 2009
Before: NORRIS, COOK, and GRIFFIN,
Circuit Judges.

COUNSEL

ARGUED: John K. Cunningham, WHITE & CASE LLP, Miami, Florida, for Appellants. Boyd A. Henderson, MILLER JOHNSON, Grand Rapids, Michigan, for Appellees.

ON BRIEF: John K. Cunningham, Matthew C. Brown, WHITE & CASE LLP, Miami, Florida, Glenn M. Kurtz, WHITE & CASE LLP, New York, New York, Robert S. Hertzberg, PEPPER HAMILTON LLP, Detroit, Michigan, Benjamin M. Mather, Michael H. Reed, PEPPER HAMILTON LLP, Philadelphia, Pennsylvania, for Appellants. Boyd A. Henderson, MILLER JOHNSON, Grand Rapids, Michigan, for Appellees.

OPINION

ALAN E. NORRIS, Circuit Judges. In this appeal, we must determine whether § 546(e) of the Bankruptcy Code applies to privately traded securities. If that is indeed the case, then the settlement payments made to defendant shareholders are exempt from avoidance. This is an issue of first impression in this circuit and we now hold, as did the bankruptcy and district courts below, that § 546(e) is not limited to publicly traded securities but also extends to transactions, such as the leveraged buyout at issue here, involving privately held securities.

I.

"When reviewing an order of a bankruptcy court on appeal from a decision of a district court, this Court 'review[s] the bankruptcy court's order directly and give[s] no deference to the district court's decision.'" *LPP Mortgage, Ltd. v. Brinley*, 547 F.3d 643, 647 (6th Cir. 2008) (quoting *In re Lee*, 530 F.3d 458, 463 (6th Cir. 2008)). We review the bankruptcy court's resolution of questions of law de novo and questions of fact for clear error. *In re Triple S Rests., Inc.*, 519 F.3d

575, 578 (6th Cir. 2008). The facts in this appeal are uncontested and hence our review is *de novo*.

Because the facts are not in dispute, we rely upon the bankruptcy court's recitation to set the stage for our discussion:

> This adversary proceeding arises from the 1999 leveraged buyout ("LBO") of the Debtor, Quality Stores, Inc. ("Quality"). The Plaintiffs, QSI Holdings, Inc. and Quality, acting through their chief litigation officer (collectively, the "Plaintiffs"), seek to avoid payments made to approximately 170 shareholders of Quality (the "Defendants") resulting from the LBO. Almost all of the Defendants have filed motions for summary judgment asserting that the transfers are exempt from avoidance based on the settlement payment defense in § 546(e) of the Bankruptcy Code. Accordingly, the legal issue presented is whether the transfers from the disbursing agent to the Defendants are exempt from avoidance because they constitute "settlement payments" made by a "financial institution" under § 546(e).
>
> . . . .
>
> . . . Quality was a privately held corporation that operated a chain of retail stores specializing in agricultural and related products. In 1999, Quality and certain of Quality's principal shareholders entered into a merger agreement with Central Tractor Farm and Country, Inc. ("Central Tractor") and its parent company, CT Holdings, Inc. (collectively the "CT Parties"). Pursuant to the agreement, Quality was to merge with and into Central Tractor, with the surviving entity changing its name to Quality Stores, Inc. The

agreement also called for Quality's shareholders to be paid, in cash or stock, for their respective equity interests. The assets of both Quality and Central Tractor were pledged as collateral for the loan that was obtained and partially utilized to pay the Quality shareholders.

The total purchase price for the LBO was approximately $208 million. Of this amount, Quality's shareholders were to receive $111.5 million in cash with $91.8 million of stock in CT Holdings, Inc. Central Tractor also agreed to assume and pay $42.1 million of Quality's existing indebtedness.

The Quality LBO involved both individual shareholders and company employees who were shareholders by virtue of their participation in Quality's Employee Stock Ownership Trust ("ESOT"). To effectuate the securities transaction contemplated by the LBO, the CT Parties made a $111.5 cash payment to their exchange agent, HSBC Bank USA ("HSBC Bank"). HSBC Bank collected the shares of Quality stock from individual shareholders. It then transferred the securities to the CT Parties and distributed the cash, or shares in CT Holdings, Inc., to the individual shareholders.

For the ESOT shareholders, many of whom were lesser paid and mid-level Quality employees, the settlement process involved one additional step. Most of the ESOT stock was held by the ESOT trustee, LaSalle Bank. LaSalle Bank tendered the shares of Quality stock to HSBC Bank and received the cash consideration. The ESOT was eventually terminated and the funds were distributed by LaSalle Bank to the ESOT participants.

As a result of the merger, Quality incurred substantial integration costs. The merged company also implemented a costly expansion plan which aggressively contemplated the opening of twenty-five to fifty new stores each year. These business decisions, and others, contributed to continuing financial difficulties which eventually led a group of petitioning creditors to file an involuntary bankruptcy petition against Quality during October 2001. In response, before an order for relief was entered, Quality filed a voluntary petition under chapter 11 on November 1, 2001.

The Plaintiffs filed this fraudulent conveyance action on October 31, 2003. The complaint, as amended, alleges that the Defendants gave less than reasonably equivalent value when they tendered their Quality stock for cash as part of the LBO. The complaint further alleges that the LBO left Quality with unreasonably small capital and caused it to incur debts beyond its ability to pay. The Plaintiffs seek to avoid and recover the LBO transfers as constructively fraudulent conveyances pursuant to 11 U.S.C. § 544, § 550, and the Michigan Uniform Fraudulent Transfer Act, Mich. Comp. Laws Ann. §§ 566.31 *et seq.* The Defendants' motions for summary judgment assert that the LBO transfers were settlement payments made by a financial institution. Therefore, the Defendants seek dismissal of this adversary proceeding because they contend that the transfers are exempt from avoidance under § 546(e).

In re Quality Stores, Inc., 355 B.R. 629, 631-32 (Bankr. W.D. Mich. 2006) (footnote omitted).

II.

A. Statutes at Issue

Section 546(e) provides as follows:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or *settlement payment*, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, *financial institution*, financial participant, or securities clearing agency that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e) (version in effect prior to December 12, 2006) (emphasis added). Section 741(8), in turn, defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8).

B. Did the LBO at Issue Involve a Settlement Payment as Defined by § 546(e)?

Plaintiffs frame the central issue on appeal as "whether payments made to purchase *non-public* securities in a leveraged buyout can be exempted from avoidance pursuant to section 546(e) of the Bankruptcy Code by merely funneling [them through] a financial institution." In their view, Congress intended that § 546(e) "insulate the nation's public securities markets from the adverse effects of a

bankruptcy, so as not to cause a ripple effect in such markets by unwinding settled securities transactions."

When construing a statute we look first to its text. Where that language is plain, "the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Lamie v. U. S. Trustee*, 540 U.S. 526, 534 (2004) (quotation omitted); *see also Thompson v. North American Stainless, L.P.*, ____F.3d____, 2009 WL 1563443, *2 (6th Cir. June 5, 2009) (en banc).

Numerous courts, including the courts below, have acknowledged that the definition of "settlement payment" set out in § 741(8) is somewhat "circular." *See Kaiser Steel Corp. v. Charles Schwab & Co., Inc.*, 913 F.2d 846, 848 (10th Cir. 1990); *QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 740 (W.D. Mich. 2007) (citing *Kaiser Steel*); *In re Quality Stores, Inc.*, 355 B.R. 629, 633 (Bankr. W.D. Mich. 2006) (same). Nonetheless, courts have recognized that the definition is "extremely broad." *See Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir. 2009) (citing *Kaiser Steel*, 913 F.2d at 848 (quoting *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 878 F.2d 742, 751 (3d Cir. 1989)); *In re Resorts Int'l, Inc.*, 181 F.3d 505, 514-15 (3d Cir. 1999); *In re Comark*, 971 F.2d 322, 326 (9th Cir. 1992)).

With this in mind, we turn to the definition of "settlement payment." For the purposes of this appeal, the critical phrase in the definition is the final one: the payment must be one "commonly used in the securities trade." 11 U.S.C. § 741(8). Plaintiffs take issue with the lower courts' failure to consider whether the LBO contained the hallmarks of a payment made in the securities trade. Specifically, they fault the district court for basing its broad reading of

"settlement payment" upon decisions that involve public, not private, securities transactions. They would have us look to the legislative history of § 546(e). That history is recounted briefly in *Kaiser Steel*:

> In 1982, Congress was concerned about the volatile nature of the commodities and securities markets, so former section 764(c) was replaced by sections 546(e) and 741(5) and (8) "to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections to the securities market." H.R. Rep. No. 420, 97th Cong., 2d Sess. 2 (1982), *reprinted in* 1982 U.S. Code Cong. & Admin. News 583, 583. The protection was expanded beyond the ordinary course of business to include margin and settlement payments to and from brokers, clearing organizations, and financial institutions. Again, Congress's purpose was "to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Id.* at 1, *reprinted in* 1982 U.S.Code Cong. & Admin.News at 583.

913 F.2d at 849 (footnote and quotation omitted). *In Kaiser Steel*, the court went on to conclude that "the transfer of consideration in an LBO is consistent with the way 'settlement' is defined in the securities industry." *Id.*

However, *Kaiser Steel* involved publicly traded securities. The question posed here is whether its logic extends to privately traded securities. In a case involving facts similar to ours, the Eighth Circuit recently held that it does. *Contemporary Indus. Corp.*, 564 F.3d at 986 ("Nothing in the relevant statutory

language suggests Congress intended to exclude these payments from the statutory definition of 'settlement payment' simply because the stock at issue was privately held"). The court construed the phrase "commonly used in the securities trade" as "a catchall phrase intended to underscore the *breadth* of the § 546(e) exemption." *Id.* We agree. While, like the Eighth Circuit, we recognize that other courts have reached a different conclusion, those courts stressed that Congress intended to protect *publicly* traded securities from market volatility caused by bankruptcy by means of § 546(e). *See, e.g., In re Norstan Apparel Shops, Inc.*, 367 B.R. 68, 76 (Bankr. E.D.N.Y. 2007). But unlike the instant case, the *Norstan* transaction involved the two sole shareholders of a closely held Subchapter S corporation, did not implicate public securities markets, and lacked many of the indicia of transactions "commonly used in the securities trade." *See Norstan*, 367 B.R. at 73. This case, on the other hand, considers a transaction with the characteristics of a common leveraged buyout involving the merger of nearly equal companies, and nothing in the statutory language indicates that Congress sought to limit that protection to publicly traded securities. The value of the privately held securities at issue is substantial and there is no reason to think that unwinding that settlement would have any less of an impact on financial markets than publicly traded securities. *Accord Contemporary Indus.*, 564 F.3d at 987.

Accordingly, we hold that nothing in the text of § 546(e) precludes its application to settlement payments involving privately held securities.

C. Did the Transaction Involve a "Transfer" to a Financial Institution?

Even if the LBO transaction qualifies as a "settlement payment," plaintiffs contend that another element of § 546(e) remains unsatisfied: the requirement that a "transfer . . . made by or to a . . . financial institution" occur. In their view, the role played by HSBC Bank in this transaction did not satisfy this requirement because it never had dominion or control over those funds. The Eleventh Circuit has taken this position, *In re Munford, Inc.*, 98 F.3d 604, 610 (11th Cir. 1996), and plaintiffs urge us to adopt its reasoning:

> True, a section 546(e) financial institution was presumptively involved in this transaction. But the bank here was nothing more than an intermediary or conduit. Funds were deposited with the bank and when the bank received the shares from the selling shareholders, it sent funds to them in exchange. The bank never acquired a beneficial interest in either the funds or the shares.
>
> Importantly, a trustee may only avoid a transfer to a "transferee." *See* 11 U.S.C. § 550. Since the bank never acquired a beneficial interest in the funds, it was not a "transferee" in the LBO transaction. *See In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1200 (11th Cir. 1988) ("When banks receive money for the sole purpose of depositing it into a customer's account . . . the bank never has actual control of the funds and is not a § 550 transferee."). Rather, the shareholders were the only "transferees" of the funds here. And, of course, section 546(e) offers no protection from the trustees avoiding powers to sharehold-

> ers; rather, section 546(e) protects only commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies. Accordingly, regardless of whether the payments qualify as settlement payments, section 546(e) is not applicable since the LBO transaction did not involve a transfer to one of the listed protected entities.

Id. at 610 (footnote omitted).

In rejecting *Munford*, the Third Circuit found that the plain language of § 546(e) simply does not require a "financial institution" to have a "beneficial interest" in the transferred funds. *In re Resorts Int'l, Inc.*, 181 F.3d at 516. The Eighth Circuit has adopted this view, *Contemporary Indus.*, 564 F.3d at 986-87 (statute does not "expressly require that the financial institution obtain a beneficial interest in the funds"), as do we. The role played by HSBC Bank in the LBO at issue was sufficient to satisfy the requirement that the transfer was made to a financial institution.

III.

The judgment is **affirmed**.

APPENDIX B

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Case No. 1:06-CV-876
Bankruptcy Adversary No. 03-88912
HON. JANET T. NEFF

QSI HOLDINGS, INC. and QUALITY STORES, INC.,
Plaintiffs-Appellants,

v.

CHERYL A. ALFORD *et al.*,
Defendants-Appellees.

ORDER

In accordance with the Opinion entered this date:

IT IS HEREBY ORDERED that the decision of the bankruptcy court, *In re Quality Stores, Inc.*, 355 B.R. 629 (Bankr. W.D. Mich. 2006), is **AFFIRMED**.

DATED: December 21, 2007

/s/ Janet T. Neff
JANET T. NEFF
United States District Judge

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Case No. 1:06-CV-876
Bankruptcy Adversary No. 03-88912
HON. JANET T. NEFF

QSI HOLDINGS, INC. and QUALITY STORES, INC.,
Plaintiffs-Appellants,

v.

CHERYL A. ALFORD *et al.*,
Defendants-Appellees.

OPINION

Plaintiffs Q. S.I. Holdings, Inc. and Quality Stores, Inc. appeal from an order of the bankruptcy court granting summary judgment in favor of defendants in a post-judgment adversary proceeding brought by plaintiffs. *In re Quality Stores, Inc.*, 355 B.R. 629 (Bankr. W.D. Mich. 2006). Plaintiffs sought avoidance of payments made to defendants, former shareholders of the debtor Quality Stores, Inc., in a leveraged buy-out[1] (LBO) of Quality Stores by Central Tractor

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[1] "A 'leveraged buyout' occurs when a group of investors acquires the stock of a company with borrowed money that is secured by the assets of the company to be purchased." The debt is subsequently repaid with money generated by the acquired company's operations or assets. The new debt creates a financial burden on the acquired company and limits its ability to secure additional financing to survive an economic downturn, which in

and Farm Country, Inc. and its affiliate, CT Holdings, Inc. The bankruptcy court concluded that the LBO payments to defendants were "settlement payments" made by a "financial institution" under 11 U.S.C. § 546(e) of the Bankruptcy Code,[2] and therefore were exempt from avoidance in bankruptcy. For the reasons that follow, this Court affirms the decision of the bankruptcy court.

I. Facts

The bankruptcy court set forth the uncontested facts for purposes of the motion for summary judgment. Those underlying facts are not at issue on appeal and are adopted by this Court as follows:

> Quality [Stores] was a privately held corporation that operated a chain of retail stores specializing in agricultural and related products. In 1999, Quality and certain of Quality's principal shareholders entered into a merger agreement with Central Tractor Farm and Country, Inc. ("Central Tractor") and its parent company, CT Holdings, Inc. (collectively the "CT Parties"). Pursuant to the agreement, Quality was to merge with and into Central Tractor, with the surviving entity changing its name to Quality Stores, Inc. The agreement also called for Quality's shareholders to be paid, in cash or stock, for their respective

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turn can force the new company into bankruptcy, even as a result of a small decline in cash flow. 19 FORDHAM URB. L.J. 87, 87 n.1 (1991).

[2] The court noted that the Bankruptcy Code is contained in 11 U.S.C. §§ 101-1330 and that the 2005 amendments to the Code, commonly referred to as "BAPCPA," were inapplicable to this adversary proceeding. *In re Quality Stores, Inc.*, 355 B.R. at 631 n. 1. The parties do not contend otherwise on appeal.

equity interests. The assets of both Quality and Central Tractor were pledged as collateral for the loan that was obtained and partially utilized to pay the Quality shareholders.

The total purchase price for the LBO was approximately $208 million. Of this amount, Quality's shareholders were to receive $111.5 million in cash with $91.8 million of stock in CT Holdings, Inc. Central Tractor also agreed to assume and pay $42.1 million of Quality's existing indebtedness.

The Quality LBO involved both individual shareholders and company employees who were shareholders by virtue of their participation in Quality's Employee Stock Ownership Trust ("ESOT"). To effectuate the securities transaction contemplated by the LBO, the CT Parties made a $111.5 [million] cash payment to their exchange agent, HSBC Bank USA ("HSBC Bank"). HSBC Bank collected the shares of Quality stock from individual shareholders. It then transferred the securities to the CT Parties and distributed the cash, or shares in CT Holdings, Inc., to the individual shareholders.

For the ESOT shareholders, many of whom were lesser paid and mid-level Quality employees, the settlement process involved one additional step. Most of the ESOT stock was held by the ESOT trustee, LaSalle Bank. LaSalle Bank tendered the shares of Quality stock to HSBC Bank and received the cash consideration.[2] The ESOT

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[2] LaSalle Bank determined that it was in the best interests of the ESOT participants to receive cash, rather than shares in CT

was eventually terminated and the funds were distributed by LaSalle Bank to the ESOT participants.

As a result of the merger, Quality incurred substantial integration costs. The merged company also implemented a costly expansion plan which aggressively contemplated the opening of twenty-five to fifty new stores each year. These business decisions, and others, contributed to continuing financial difficulties which eventually led a group of petitioning creditors to file an involuntary bankruptcy petition against Quality during October 2001. In response, before an order for relief was entered. Quality filed a voluntary petition under chapter 11 on November 1, 2001.

The Plaintiffs filed this fraudulent conveyance action on October 31, 2003. The complaint, as amended, alleges that the Defendants gave less than reasonably equivalent value when they tendered their Quality stock for cash as part of the LBO. The complaint further alleges that the LBO left Quality with unreasonably small capital and caused it to incur debts beyond its ability to pay. The Plaintiffs seek to avoid and recover the LBO transfers as constructively fraudulent conveyances pursuant to 11 U.S.C. § 544, § 550, and the Michigan Uniform Fraudulent Transfer Act, Mich. Comp. Laws Ann. §§ 566.31 *et seq*. The Defendants' motions for summary judgment assert that the LBO transfers were settlement payments made by a financial institution. Therefore, the Defendants seek dismissal of this adversary

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Holdings, Inc. Presumably, this was a decision that LaSalle Bank could legally make.

> proceeding because they contend that the transfers are exempt from avoidance under § 546(e).

In re Quality Stores, Inc., 355 B.R. at 631-632.

Following a thorough analysis of the relevant statutes and decisions from our sister circuits, the bankruptcy court granted the moving defendants' motions for summary judgment. *Id.* at 632- 636. Further, because the § 546(e) defense applied equally to all defendants in the adversary proceeding, the court sua sponte granted summary judgment in favor of the nonmoving defendants. *In re Quality Stores, Inc.*, 355 B.R. at 636.

II. Standard of Review

On appeal to this Court from a bankruptcy court's final order or judgment, the bankruptcy court's conclusions of law are reviewed de novo. *In re Rowell*, 359 F. Supp. 2d 645, 647 (W.D. Mich. 2004). Issues of statutory interpretation are questions of law, and are thus subject to the de novo standard. *Kessler, Inc. v United States Trustee (In re Kessler),* 142 B.R. 796, 799 (W.D. Mich. 1992). The district court may affirm, modify, or reverse a bankruptcy's judge's judgment, order, or decree or remand with instructions for further proceedings. FED. R. BANKR. P. 8013.

"Rule 56 of the Federal Rules of Civil Procedures [sic] governs summary judgment motions in bankruptcy court adversary proceedings." *In re Rowell*, 359 F. Supp. 2d at 647 (citing FED. R. BANKR. P. 7056). A motion for summary judgment is properly granted if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. FED. R. CIV. P. 56(c). A court may enter summary judgment sua sponte in favor of a nonmoving party so long as the losing party was on

notice to present all desired evidence on the matter at issue. *Celotex Corp. v. Catrett*, 477 U.S. 317, 326 (1986); *Salehpour v. Univ. of Tennessee*, 159 F.3d 199, 204 (6th Cir. 1998).

III. Discussion

This appeal brings the Court to an uncertain intersection of bankruptcy law and securities law. *See Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l, Inc.)*, 181 F.3d 505, 515 (3d Cir. 1999); *Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer S & L Ass'n (In re Bevill, Bresler & Schulman Asset Mgmt. Corp.)*, 878 F.2d 742, 751 (3d Cir. 1989). At issue are provisions in the Bankruptcy Code providing for an exemption to avoidance for "settlement payments" in the securities trade, made by or to a financial institution pursuant to 11 U.S.C. § 546(e), which provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, *the trustee may not avoid a transfer that is* a margin payment, as defined in section 101, 741, or 761 of this title, or *settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of)* a commodity broker, forward contract merchant, stockbroker, *financial institution*, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the

> case, except under section 548(a)(1)(A)[3] of this title. (Emphasis added.)

The Bankruptcy Code, 11 U.S.C. § 741,[4] defines "settlement payment" for purposes of § 546(e): "'settlement payment' means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8).

The key question for decision is whether the term "settlement payment" as defined exempts the payments made in the LBO of Quality Stores, Inc., to acquire the privately held shares of stock. This is an issue of first impression in the Sixth Circuit. While other courts have addressed aspects of this question, including whether the term "settlement payment" includes payments made in an LBO of a public company, and whether the term may include payment for privately held securities, the bankruptcy court's decision in this case charts new territory regarding the extent of the § 546(e) exemption. Having fully considered the statutory language, and the legal and historical context of § 546(e), this Court is persuaded that no principled basis exists for denying application of the exemption in this case.

Question of Statutory Interpretation

This appeal presents an issue of statutory interpretation. When interpreting a statute, courts must first

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[3] Section 548(a)(1)(A) pertains to intentional fraudulent transfers and is inapplicable to this case.

[4] The definition in § 101(51A) applies to forward contract provisions under the Bankruptcy Code and is inapplicable to the circumstances of this case.

consider the plain language of the statute, and resort to a review of congressional intent or legislative history only when the language of the statute is not clear. *In re Comshare, Inc., Securities Litigation*, 183 F.3d 542, 549 (6th Cir. 1999).

> As with any question of statutory interpretation, we must first look to the language of the statute itself. If the language of the statute is clear, then the inquiry is complete, and the court should look no further. Only if the statute is "inescapably ambiguous" should a court look to other persuasive authority in an attempt to discern legislative meaning. Persuasive authority can include other statutes, interpretations by other courts, legislative history, policy rationales, and the context in which the statute was passed.

Brilliance Audio, Inc. v. Haights Cross Commc'ns, Inc., 474 F.3d 365, 371-372 (6th Cir. 2007) (citations omitted).

Background and
Purpose of the Section 546(e) Exemption

Section 546(e) exempts from avoidance, either as preferences or fraudulent transfers under state law and federal bankruptcy law, certain transfers by debtors that meet the statutory requirements. This exemption is an exception to public policy underlying the avoidance provisions in the Bankruptcy Code—intended to prevent a debtor from diminishing funds that are generally available for distribution to creditors—in favor of a policy of maintaining stability in the securities market. *Kaiser Steel Corp. v. Charles Schwab & Co., Inc. (In re Kaiser Steel Corp.)*, 913 F.2d 846, 849 (10th Cir. 1990) ("*Kaiser I*"); *In re Chase & Sanborn Corp.*, 813 F.2d 1177, 1181 (11th Cir. 1987).

The § 546(e) exemption effectively provides a "safe harbor" for certain types of transactions since its purpose is "'to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions.'" *Enron Corp. v. Credit Suisse First Boston Int'l (In re Enron Corp.)*, 328 B.R. 58, 66 (Bankr. S.D.N.Y. 2005) (quoting *Kaiser I*, 913 F.2d at 848). Congress enacted the "safe harbor" provisions of §546(e) to "'ensure that the avoiding powers of a trustee are not construed to permit margin or settlement payments to be set aside except in cases of fraud [by the purchaser].'" *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 878 F.2d at 751 (quoting H.R. REP. NO. 97-420 (1982) ("1982 House Report"), *reprinted in* 1982 U.S. Code Cong. & Admin. News 583, 583).

When first enacted in 1978, the exemption applied to only the commodities market.[5] *Kaiser I*, 913 F.2d at 848-849; *In re Enron Corp.*, 328 B.R. at 66 (2005). The commodities exemption was limited to margin payments to brokers and settlement payments from clearing organizations, and the term "settlement payment" was not defined. *Kaiser I*, 913 F.2d at 849. In 1982, however, Congress was concerned with the volatile nature of the commodities and securities markets, and "so former section 764(c) was replaced by sections 546(e) and 741(5) and (8) 'to clarify and, in some instances, broaden the commodities market protections and expressly extend similar protections

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[5] *See* 11 U. S.C. § 764(c) (repealed 1982). The exemption was a response to *Seligson v. New York Produce Exchange*, 394 F. Supp. 125 (S.D.N.Y. 1975), which held that a trustee could recover a margin payment made to a commodities clearinghouse. *Kaiser I*, 913 F.2d at 849 n.4 (citing White, *The Commodity-Related Provisions of the Bankruptcy Act of 1978*, 34 Rec. Bar. A. Bar City of New York 262, 269-271 (1979)).

to the securities market.'" *Kaiser I*, 913 F.2d at 849 (quoting 1982 House Report); *see also In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 878 F.2d at 747. The 1982 amendments expanded the exemption to include margin and settlement payments to and from brokers, clearing organizations, and financial institutions. *Kaiser I*, 913 F.2d at 849.

Thus, while the Bankruptcy Code gives broad powers to a trustee to avoid transactions involving preferential or fraudulent transfers that deplete the bankruptcy estate, the enactment of § 546(e) also acknowledges that avoidance of settled securities transactions could wreak havoc on the already volatile commodities and securities markets. *Kaiser I*, 913 F.2d at 849; *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 878 F.2d at 751. The "ripple effect" from a major bankruptcy affecting the commodities and securities markets could potentially displace many investments and threaten the solvency of many additional institutions. *Kaiser I,* 913 F.2d at 849; *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.*, 878 F.2d at 751. In short, § 546(e) protects the nation's financial markets from the instability that would be caused by the reversal of settled securities transactions. *Kaiser I,* 913 F.2d at 848. It also creates the tension between these two areas of law that leads to the instant litigation.

While the purpose of the § 546(e) exemption is easily understood from a policy standpoint, it has proved far more difficult to understand in practical application. Given the cross purposes of bankruptcy creditors and former shareholders or other prebankruptcy payment recipients, the § 546(e) exemption has become a battleground of semantics and legal frameworks as litigants and the courts attempt to establish its limits

within the statutory language. Despite numerous cases that have considered the statutory language and legislative history of §§ 546(e) and 741(8) in an attempt to discern the Congressional intent, little has been gleaned to formulate any decisive standard to determine which transactions fall within the exemption. Consequently, some 25 years after the enactment of the exemption from avoidance for settlement payments in the securities trade, the courts continue to be a forum for disputes over the construction of §§ 546(e) and 741(8). This case is a prime example of the search for a judicial resolution of the correct statutory application.

Arguments

The parties are diametrically opposed on issues of legal analysis as well as outcome. Plaintiffs argue that the § 546(e) exemption for settlement payments is limited to publicly traded securities and that Congress did not intend to exempt transactions such as an LBO of privately held stock because such payments are not "commonly used in the securities trade," as defined in § 741(8). Defendants respond that the statutory definition of "settlement payment" has been broadly construed based on the plain language of the statute and that a substantial majority of circuit courts that have ruled on this issue have held that the § 546(e) exemption applies even when the securities are privately held and the centralized clearance system is not involved.

Plaintiffs further argue that the expansive view of the § 546(e) exemption advocated by the Third and Tenth Circuits, and followed by the bankruptcy court in this case, is erroneous in the context of this case, "a one-off private transaction involving privately-held stock." They contend that the statutory definition of

"settlement payment" is inherently ambiguous, which requires that the court look beyond the text to resolve the ambiguity and determine legislative intent. Defendants respond that, as the bankruptcy court reasoned, the plain meaning of the statutes is clear and unambiguous, and consideration of the legislative history is unwarranted; no further inquiry by the court is necessary unless applying the plain language leads to an absurd result, which in this case it does not.

Analysis

In attempting to discern the limits of the § 546(e) exemption, the Court must first look to the statutory language. Only if the statutory language is unclear is resort to a review of congressional intent or legislative history permissible. *In re Comshare, Inc.*, 183 F.3d at 549. "Only if the statute is 'inescapably ambiguous' should a court look to other persuasive authority in an attempt to discern legislative meaning." *Brilliance Audio, Inc.*, 474 F.3d at 371-372 (citations omitted). Nonetheless, even where the language of the statute is unambiguous, courts may still consider legislative intent if enforcing the words as written would lead to an absurd result:[6]

> [W]hile it is axiomatic that where the legislative scheme is coherent and consistent the court need not inquire beyond the text of the statute,

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[6] Defendants question whether this standard remains valid in light of recent Supreme Court decisions, e.g., *Exxon Mobil Corp. v. Allapattah Servs., Inc.*, 545 U. S. 546 (2005), which they assert require federal courts to interpret statutes in accordance with the plain language and meaning without referring to legislative history or other extrinsic evidence. This issue need not be resolved because, as discussed, *infra*, the application of the plain meaning does not lead to an absurd result in this case.

> in cases where the plain language, even if literally applicable, would yield absurd results at odds with the statutory design, courts may look beyond the printed word to the law as a whole and its purposes and policy, so as to determine what particular legislative intent may apply.

Jackson v. Mishkin (In re Adler, Coleman Clearing Corp.), 263 B.R. 406, 478 (S.D.N.Y. 2001).

Looking to the § 741(8) definition of "settlement payment," it is beyond dispute that the statute lacks sufficient definition to determine precisely what constitutes a "settlement payment" in any specific context: "'settlement payment' means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U. S.C. § 741(8). The courts have struggled to remedy this lack of specificity by applying various rules of construction or analytical frameworks to develop some logical approach to practical application of the definition. Compare *Kaiser I*, 913 F.2d at 848 (the definition, while somewhat circular is "extremely broad" and clearly includes anything that may be considered a settlement payment) with *Official Comm. of Unsecured Creditors v. ASEA Brown Boveri, Inc. (In re Grand Eagle Cos., Inc.)*, 288 B.R. 484, 492 (Bankr. N.D. Ohio 2003) ("reflexive aspect of this provision, i.e., defining the meaning of 'settlement payment' by listing a variety of types of 'settlement payments,' requires the reader to consider extrinsic information and the final modifying phrase"); and *Official Comm. of Unsecured Creditors of Norstan Apparel Shops, Inc. v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68, 76 (Bankr. E.D. N.Y.

2007) (the concluding phrase "or any other similar payment commonly used in the securities trade" modifies the definition of settlement payment "because in its absence of the concluding phrase, the statutory definition contained in § 741(8) would be, in effect, a meaningless tautology").

Absent clear statutory guidance concerning the extent of the § 546(e) exemption, two contrary views of the § 546(e) exemption for settlement payments have evolved. Under the broader view, the exemption includes any payment normally regarded as part of the settlement process because the plain language of the statute does not limit the exemption to transactions involving only publicly traded securities. *See, e.g., Jonas v. Resolution Trust Corp. (In re Comark)*, 971 F.2d 322, 326 (9th Cir. 1992) (joining the Third and Tenth Circuits in broadly defining the term settlement payment to include transfers that are normally regarded as part of the settlement process); *Official Comm. of Unsecured Creditors of The IT Group, Inc. v. Acres of Diamonds, L.P., (In re The IT Group, Inc.),* 359 B.R. 97, 101 (Bankr. D. Del. 2006) ("the term settlement payment is to be applied broadly to any transfer of stock or cash to pay for stock," and the fact that the stock was sold privately rather than on the public stock market is not a distinguishing factor).

The contrary view, argued by plaintiffs, is that the settlement payment exemption is limited to publicly traded securities and that Congress did not intend to exempt transactions such as an LBO of privately held stock. *See, e.g., In re Norstan Apparel Shops, Inc.*, 367 B.R. at 75-76 (quoting *In re Adler, Coleman Clearing Corp.*, 263 B.R. at 478) (internal quotations omitted) ("while the term 'settlement payment' as used in

§ 546(e) 'is to be read broadly, the term is not boundless,'" and thus it must read to include only a transaction involving the public securities market).

In this case, the bankruptcy court adopted the former view and granted summary judgment for defendants on the basis that the definition of settlement payment in § 741(8) has been recognized as "extremely broad," and that the Tenth Circuit Court of Appeals, as well as other courts, have applied this broad definition of "settlement payment" to transfers of consideration made in connection with an LBO. *In re Quality Stores, Inc.*, 355 B.R. at 633 (quoting *Kaiser I*, 913 F2d. at 848 and citing additionally *In re Resorts Int'l, Inc.*, 181 F.3d at 515-516); and *In re Comark*, 971 F.2d at 326; *see also Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.) ("Kaiser II")*, 952 F.2d 1230 (10th Cir. 1991). This Court finds no error in the bankruptcy court's general reasoning and conclusion.

As the bankruptcy court noted, the Tenth Circuit has held that payments made to shareholders through their securities broker, Charles Schwab & Co., were "settlement payments" exempt from avoidance under § 546(e). *In re Quality Stores, Inc.*, 355 B.R. at 633 (citing *Kaiser I*). Further, in *Kaiser II*, the court extended its holding to include transfers made from the disbursing agent directly to individual shareholders. *In re Quality Stores, Inc.*, 355 B.R. at 633. And in both cases the Tenth Circuit relied on the definition of settlement payment found in § 741(8), concluding that the definition was intended to include any transfer that would be considered a settlement payment in the securities industry. *In re Quality Stores, Inc.*, 355 B.R. at 633. Because the securities industry generally defines settlement as "the completion of a securities transaction," *Kaiser I*, 913 F.2d at 849, interpreting

"settlement payment" to include the transfer of consideration in an LBO is consistent with the securities industry definition of "settlement." *In re Quality Stores, Inc.*, 355 B.R. at 633-634.

Further, nothing in the plain language of the statutes limits the application of the exemption to public transactions. As defendants point out (Df. Brief 16), decisions of the Fifth and Ninth Circuits have determined that transactions involving "repos" and forward contracts are subject to the § 546(e) exemption regardless whether the transactions involved public or private securities and whether the transactions would trigger the centralized clearance system if avoided by the trustee in bankruptcy. *In re Comark*, 971 F.2d 322; *Williams v Morgan Stanley Capital Group, Inc. (In re Olympic Natural Gas Co.)*, 294 F.3d 737 (5th Cir. 2002).

Contrary to plaintiffs' arguments, the statutory language is not "inescapably ambiguous."

Merely because the statutory definition is broad does not render it ambiguous. In defining what constitutes a settlement payment, Congress chose an inclusive, rather than exclusive definition. The statutory definition is more in the nature of a "catch-all," which leaves to the courts the task of winnowing out those transactions that do not comport with the statutory provisions or Congressional intent and thus lead to an absurd result.

In this case, there are no exceptional circumstances to depart from the generally accepted broad view of the term "settlement payment." Given the plain language of the statute, the case law, and the circumstances of this case, the payments to defendants must be deemed to fall within the § 546(e) exemption for a

"settlement payment." This Court finds no error in the bankruptcy court's conclusion that the payments made to defendants to effect the LBO are settlement payments as defined in § 741(8).

Plaintiffs nonetheless argue that even if the language is not ambiguous, it leads to an absurd result in this case, and thus should not be enforced. "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.' In such cases, the intention of the drafters, rather than the strict language, controls." *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242-243 (1989). (citations omitted). Plaintiffs contend that the bankruptcy court's decision leads to an unreasonable result by permitting shareholders to retain otherwise voidable payments and granting them priority over the creditors without effectuating Congress' intent of promoting stable financial markets. (Pl. Brief 22.) To do so, they argue, "conflicts with the Bankruptcy Code's design to augment property of the estate for the benefit of creditors and accord priority to the rights of creditors over the interests of equity security holders." (*Id.*)

This Court finds no such infirmity in applying the exemption in the circumstances of this case. The record reflects that one of the creditors seeking the benefit of avoidance in fact provided financing for the LBO of Quality Stores, and thus would have been fully aware of the financial context of the LBO. This undermines any argument that the equities rest with creditors as opposed to the approximately 170 shareholders, *In re Quality Stores, Inc.*, 355 B.R. at 631, many of whom are mid—and lower—level ESOT

employee-shareholders, whose stock payments would be voided in favor of the creditors.

Moreover, plaintiffs provide no support for their contention that applying the exemption does not further Congressional intent to promote stability in the financial and securities markets. Given the multitude of shareholders involved in this case, many of whom likely reinvested the proceeds, it is questionable whether the undoing of the hundreds of transactions would not cause some disruption in the securities market.

Finally, regarding plaintiffs' claim that the court erred in determining that the settlement payments were "transfers" made "by" a "financial institution," the bankruptcy court's reasoning and conclusion are likewise sound. Plaintiffs have raised no persuasive basis for reversing the bankruptcy court's finding that the payments made to defendants were made "by . . . a financial institution" pursuant to §546(e), and thus protected from avoidance. On appeal, as before the bankruptcy court, plaintiffs argued that the transfers at issue were not made "by . . . a financial institution" pursuant to § 546(e) because the disbursing agent never acquired a beneficial interest in the LBO consideration. *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996). In *Munford*, a divided court found that the bank responsible for conveying payments was not a "transferee" because it never acquired a beneficial interest in the funds. *Id.* at 610. The holding in *Munford*, which requires that the disbursing agent acquire a beneficial interest in the LBO consideration for the § 546(e) exemption to apply, is not supported by the plain language of the statute.

This Court agrees with the bankruptcy court that although the result in *Munford* may be viewed as fair, there is no requirement in § 546(e) that a financial institution acquire a beneficial interest in the funds it handles for § 546(e) to apply. Accordingly, the courts may not impose policy limitations not expressly stated in the statute. *In re Quality Stores, Inc.*, 355 B.R. at 635- 636.

To the extent that plaintiffs assert that upholding the exemption in this case creates the potential for widespread abuse of the § 546(e) exemption, this Court finds the concern overstated. Plaintiffs argue that the bankruptcy court's application of § 546(e) leads to an absurd result—the "unfettered ability of troubled companies to cash-out their shareholders before bankruptcy, to the detriment of the companies' creditors," which circumvents other provisions of the Bankruptcy Code. (Pl. Brief 38). In the absence of clear statutory guidance concerning the extent of the § 546(e) exemption, the courts have effectively resorted to a case-by-case determination of the merits of exemption. The result is a spectrum of decisions finding transactions of varying types within the purview of the settlement payment exemption, while excluding others. The result is a "broad, but not boundless" interpretation of the exemption by the courts. *See In re Norstan Apparel Shops, Inc.*, 367 B.R. at 76; *In re Adler, Coleman Clearing Corp.*, 263 B.R. at 478. And while the bankruptcy and securities systems, like any complex scheme, are targets for abuse, in those transactions in which such abuse seems evident, a statutory safety valve exists. The courts have generally determined that, by definition, a settlement payment must be commonly used in the securities trade. *Kaiser II*, 952 F.2d at 1237. It is therefore unlikely that a transaction that is a clear

abuse of the exemption could be said to be commonly used in the securities trade. *See, e.g.*, *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 539, 541 (B.A.P. 9th Cir. 2005) (transactions in illegally unregistered securities are not "commonly used in the securities trade"). "[D]ecisions that involve outright illegality or transparent manipulation reject § 546(e) protection." *Id.* Accordingly, until such time as Congress deems it prudent or necessary to amend the statute, the courts will continue to winnow out those exceptional cases at the far end of the spectrum where the exemption is unwarranted.[7]

IV. Conclusion

This Court finds no basis for reversal of the grant of summary judgment in favor of defendants. The plain language of the statute neither limits applica-

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[7] A series of cases in the Enron bankruptcy proceedings bears out the of the validity of this conclusion in practice. In four cases, the bankruptcy court, Arthur J. Gonzalez, J. applied the statutory framework to the facts of each case, reaching different results in determining whether the transactions qualified as settlement payments. *Enron Corp. v. Int'l Fin. Corp. (In re Enron Corp.)*, 341 B.R. 451 (Bankr. S.D.N.Y. 2006) (prepetition payments to acquire notes from trust in excess of value to protect credit rating were in the nature of settlement payments); *In re Enron Corp.*, 328 B.R. 58 (debtor's payment to acquire its own shares did not qualify as settlement payment); *Enron Corp. v. J.P Morgan Sec., Inc. (In re Enron Corp.)*, 325 B.R. 671 (Bankr. S.D.N.Y. 2005) (whether payments made for short term commercial paper before maturity date, at significantly above-market prices and contrary to the offering documents, were settlement payments was a factual issue requiring trial); *Enron Corp. v. Bear, Stearns Int'l Ltd. (In re Enron Corp.)*, 323 B.R. 857 (Bankr. S.D.N.Y. 2005) (payment made to acquire own shares when debtor was insolvent or rendered insolvent by the transaction would not qualify as settlement payment).

tion of the term "settlement payment" to transactions involving only publicly traded securities nor does it exclude LBO payments. And there is no convincing support for plaintiffs' claim that enforcing the plain and unambiguous provisions of the statute conflicts with Congress' intent in enacting the statute and thus leads to an absurd result. "[G]iven the fact that disruption in the securities industry—an inevitable result if leveraged buy outs can freely be unwound years after they occurred—is also a harm the statute was designed to avoid," no absurd result occurs. *Kaiser II*, 952 F.2d at 1241. The statute must be enforced in accordance with its plain language.

DATED: December 21, 2007

/s/ Janet T. Neff
JANET T. NEFF
United States District Judge

APPENDIX C

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT
OF MICHIGAN

Case No. GG 01-10662
(Jointly Administered)
Chapter 11

Adversary Proceeding
No. 03-88912

In re: QUALITY STORES, INC., *et al.*,
Debtors.

QSI HOLDINGS, INC. and QUALITY STORES, INC.,
Plaintiffs,

v.

CHERYL A. ALFORD, *et al.*,
Defendants.

ORDER GRANTING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT. ENTERING SUMMARY JUDGMENT IN FAVOR OF NON-MOVING DEFENDANTS, AND DISMISSING ADVERSARY PROCEEDING

At a session of said court of bankruptcy, held in and for said district, on October 26, 2006.

PRESENT: HONORABLE JAMES D. GREGG
United States Bankruptcy Judge

In accordance with an Opinion Granting Defendants' Motions for Summary Judgment under 11 U.S.C. § 546(e), signed on this date, which reasoning is incorporated herein;

NOW, THEREFORE, IT IS HEREBY ORDERED that the Defendants' motions for summary judgment be, and hereby are, GRANTED.

IT IS FURTHER ORDERED that summary judgment be, and hereby is, entered in favor of all non-moving Defendants in this adversary proceeding.

IT IS FURTHER ORDERED that this adversary proceeding be, and hereby is, DISMISSED.

IT IS FURTHER ORDERED, in accordance with Bankruptcy Rule 8002(c)(2), that the time to appeal this order be, and hereby is, extended to thirty (30) days after the order is entered.

IT IS FURTHER ORDERED that a copy of this order be served by electronic means (ECF) or first-class United States mail, postage pre-paid, upon all parties listed on the special mailing matrix for this adversary proceeding.

/s/ James D. Gregg
Honorable James D. Gregg
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT
OF MICHIGAN

Case No. GG 01-10662
(Jointly Administered)
Chapter 11

Adversary Proceeding
No. 03-88912

In re: QUALITY STORES, INC., *et al.*,
Debtors.

QSI HOLDINGS, INC. and QUALITY STORES, INC.,
Plaintiffs,

v.

CHERYL A. ALFORD, *et al.*,
Defendants.

OPINION GRANTING DEFENDANTS' MOTIONS
FOR SUMMARY JUDGMENT
UNDER 11 U.S.C. § 546(e)

Appearances:

Robert S. Hertzberg, Esq., Pepper Hamilton, LLP, Detroit, Michigan.

Benjamin M. Mather, Esq., Pepper Hamilton, LLP, Philadelphia, Pennsylvania.

John K. Cunningham, Esq., White & Case, LLP, Miami, Florida.

Robert H. Skilton III, Esq., and Michael B. O'Neal, Esq., Warner Norcross & Judd, LLP, Grand Rapids, Michigan.

Boyd A. Henderson, Esq., and Thomas P. Sarb, Esq., Miller Johnson, PLC, Grand Rapids, Michigan.
J. Richard Colbeck, Esq., Richard Colbeck, PC, Coldwater, Michigan.
John A. Watts, Esq., John A. Watts, PC, Allegan, Michigan.
Jeffrey W. Bowling, Esq., Brandabur & Bowling Co., LPA, Hamilton, Ohio.
Paul R.F. Princi, Esq., Princi & King Co., LPA, Troy, Ohio.
William R. Sininger, Esq., Williams Hughes Corwin and Sininger, LLP, Muskegon, Michigan.
Douglas A. Springstead, Esq., Springstead Waltz Springstead & Fox, PC, Hart, Michigan.
Gary T. Britton, Esq., Britton & Bossenbroek, PC, Muskegon, Michigan.

I. ISSUE.

This adversary proceeding arises from the 1999 leveraged buyout ("LBO") of the Debtor, Quality Stores, Inc. ("Quality"). The Plaintiffs, QSI Holdings, Inc. and Quality, acting through their chief litigation officer (collectively, the "Plaintiffs"), seek to avoid payments made to approximately 170 shareholders of Quality (the "Defendants") resulting from the LBO. Almost all of the Defendants have filed motions for summary judgment asserting that the transfers are exempt from avoidance based on the settlement payment defense in § 546(e) of the Bankruptcy Code.[1]

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[1] The Bankruptcy Code is contained in 11 U.S.C. §§ 101-1330. The 2005 amendments to the Bankruptcy Code, commonly referred to as "BAPCPA," are not applicable in this adversary proceeding. Therefore, unless stated to the contrary, all future statutory references are to the pre-BAPCPA Bankruptcy Code, *e.g.*, "§ __."

Accordingly, the legal issue presented is whether the transfers from the disbursing agent to the Defendants are exempt from avoidance because they constitute "settlement payments" made by a "financial institution" under § 546(e).

II. JURISDICTION.

The court has subject matter jurisdiction over this bankruptcy case and this adversary proceeding. 28 U.S.C. § 1334. The case and all related proceedings have been referred to this court for decision. 28 U.S.C. § 157(a) and L.R. 83.2(a) (W.D. Mich.). This adversary proceeding is a core proceeding because the Plaintiffs seek to determine, avoid or recover fraudulent conveyances, 28 U.S.C. § 157(b)(2)(H).

III. FACTS.

For purposes of this summary judgment motion, the facts are uncontested. Quality was a privately held corporation that operated a chain of retail stores specializing in agricultural and related products. In 1999, Quality and certain of Quality's principal shareholders entered into a merger agreement with Central Tractor Farm and Country, Inc. ("Central Tractor") and its parent company, CT Holdings, Inc. (collectively the "CT Parties"). Pursuant to the agreement, Quality was to merge with and into Central Tractor, with the surviving entity changing its name to Quality Stores, Inc. The agreement also called for Quality's shareholders to be paid, in cash or stock, for their respective equity interests. The assets of both Quality and Central Tractor were pledged as collateral for the loan that was obtained and partially utilized to pay the Quality shareholders.

The total purchase price for the LBO was approximately $208 million. Of this amount, Quality's

shareholders were to receive $111.5 million in cash with $91.8 million of stock in CT Holdings, Inc. Central Tractor also agreed to assume and pay $42.1 million of Quality's existing indebtedness.

The Quality LBO involved both individual shareholders and company employees who were shareholders by virtue of their participation in Quality's Employee Stock Ownership Trust ("ESOT"), To effectuate the securities transaction contemplated by the LBO, the CT Parties made a $111.5 cash payment to their exchange agent, HSBC Bank USA ("HSBC Bank"). HSBC Bank collected the shares of Quality stock from individual shareholders. It then transferred the securities to the CT Parties and distributed the cash, or shares in CT Holdings, Inc., to the individual shareholders.

For the ESOT shareholders, many of whom were lesser paid and mid-level Quality employees, the settlement process involved one additional step. Most of the ESOT stock was held by the ESOT trustee, LaSalle Bank. LaSalle Bank tendered the shares of Quality stock to HSBC Bank and received the cash consideration.[2] The ESOT was eventually terminated and the funds were distributed by LaSalle Bank to the ESOT participants.

As a result of the merger, Quality incurred substantial integration costs. The merged company also implemented a costly expansion plan which aggressively contemplated the opening of twenty-five to fifty new stores each year. These business deci-

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[2] LaSalle Bank determined that it was in the best interests of the ESOT participants to receive cash, rather than shares in CT Holdings, Inc. Presumably, this was a decision that LaSalle Bank could legally make.

sions, and others, contributed to continuing financial difficulties which eventually led a group of petitioning creditors to file an involuntary bankruptcy petition against Quality during October 2001. In response, before an order for relief was entered, Quality filed a voluntary petition under chapter 11 on November 1, 2001.

The Plaintiffs filed this fraudulent conveyance action on October 31, 2003. The complaint, as amended, alleges that the Defendants gave less than reasonably equivalent value when they tendered their Quality stock for cash as part of the LBO.

The complaint further alleges that the LBO left Quality with unreasonably small capital and caused it to incur debts beyond its ability to pay. The Plaintiffs seek to avoid and recover the LBO transfers as constructively fraudulent conveyances pursuant to 11 U.S.C. § 544, § 550, and the Michigan Uniform Fraudulent Transfer Act, Mich. Comp. Laws Ann. §§ 566.31 et seq. The Defendants' motions for summary judgment assert that the LBO transfers were settlement payments made by a financial institution. Therefore, the Defendants seek dismissal of this adversary proceeding because they contend that the transfers are exempt from avoidance under § 546(e).

IV. DISCUSSION.

The Plaintiffs commenced their fraudulent conveyance actions under § 544(b) of the Bankruptcy Code. Section 544(b) authorizes bankruptcy trustees to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law." 11 U.S.C. § 544(b) (incorporating the Michigan Uniform Fraudulent Transfer Act, Mich. Comp. Laws Ann. §§ 566.31

et seq.). The Defendants assert that the LBO transfers are not subject to avoidance because they were settlement payments made by a financial institution under § 546(e). Section 546(e) states in pertinent part:

> Notwithstanding section[ ] 544 . . . of this title, the trustee may not avoid a transfer that is a margin payment . . . or *settlement payment*, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, *financial institution*, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

11 U.S.C. § 546(e) (emphasis added).[3]

Whether the payments to the Defendants constitute "settlement payments" made by a "financial institution" under § 546(e) is a question of statutory construction. Lowenschuss v. Resorts Int'l. Inc. (In re Resorts Int'l. Inc.), 181 F.3d 505, 515 (3d Cir. 1999), cert. denied, 528 U.S. 1021, 120 S. Ct. 531 (1999); Jonas v. Resolution Trust Corp. (In re Comark), 971 F.2d 322, 324-25 (9th Cir. 1992). To answer this question, the court must look first to the plain language of the statute. United States v. Ron Pair Enters. Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 1030 (1989); In re Standard Oil & Exploration of Del. Inc., 136 B.R. 141, 149 (Bankr. W.D. Mich, 1992). "When the language is clear, no further inquiry is necessary unless applying the plain language leads to an absurd result." In re Resorts Int'l, Inc., 181 F.3d at

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[3] By excepting transfers subject to avoidance under § 548(a)(1)(A), the defense provided by § 546(e) does not extend to transfers made within one year of the filing date with *actual intent* to hinder, delay or defraud a creditor.

515; see Ron Pair Enters., Inc., 489 U.S. at 241, 109 S. Ct. at 1030 (when a "statute's language is plain, 'the sole function of the courts is to enforce it according to its terms") (citation omitted).

Section 741 defines "settlement payment" as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment or any other similar payment commonly used in the securities trade." 11 U.S.C. § 741(8); see also 11 U.S.C. § 101(51A) (using same definition "for purposes of the forward contract provisions" of the Bankruptcy Code). Although this definition has been criticized for being "somewhat circular," it is also recognized as "extremely broad." Kaiser Steel Corp. v. Charles Schwab & Co., Inc. ("Kaiser I"), 913 F.2d 846, 848 (10th Cir. 1990); see In re Resorts Int'l, Inc., 181 F.3d at 515-16; In re Comark, 971 F.2d at 326.

The Tenth Circuit Court of Appeals is one of several courts that have applied this broad definition of "settlement payment" to transfers of consideration made in connection with an LBO. Kaiser I, 913 F.2d at 846; Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp) ("Kaiser II"), 952 F.2d 1230 (10th Cir. 1991), cert. denied, 505 U.S. 1213, 112 S.Ct. 3015 (1992). In the early 1980s, Kaiser Steel, a publicly traded corporation, was bought by an outside acquisition group. The Kaiser LBO required Kaiser's shareholders to tender their shares of common stock to the company's disbursing agent, The disbursing agent then distributed cash and stock in the surviving entity to the shareholders. In Kaiser I, the court determined that payments made to shareholders through their securities broker, Charles Schwab & Co., were "settlement payments" exempt from avoid-

ance under § 546(e). In Kaiser II, the court extended its holding to include transfers made from the disbursing agent directly to individual shareholders.

In both cases, the Tenth Circuit began its analysis with the statutory definition of settlement payment found in § 741(8). Kaiser I, 913 F.2d at 848; Kaiser II, 952 F.2d at 1237, The court concluded that this definition is intended to include any transfer which would be considered a settlement payment in the securities industry. Kaiser I, 913 F.2d at 848. The court further noted that the securities industry generally defines settlement as "the completion of a securities transaction."[4] Kaiser I, 913 F.2d at 849 (citing various securities industry texts). Thus, "interpreting 'settlement payment' to include the transfer of consideration in an LBO is consistent with the way 'settlement' is defined in the securities industry." Kaiser I, 913 F.2d at 849.

The Tenth Circuit also stated that its interpretation of "settlement payment" was consistent with the legislative intent behind § 546. Kaiser I, 913 F.2d at 848. The court explained that Congress first enacted § 546(e) in 1978 to "promote customer confidence in commodity markets . . ." Id. at 849 (citing S. Rep. No. 95-989, at 8 (1978), as reprinted in 1978 U.S.C.C.A.N. 5787, 5794). Because the defense "only applied to

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[4] In Kaiser II, the court explained that a routine securities transaction provides two opportunities for settlement. The first, a "street-side settlement," occurs between the brokers and the clearing agency, which acts as an intermediary between the brokers. Kaiser II, 952 F.2d at 1237-38. The second, "a 'customer-side settlement' . . . occurs between the broker and its customer." Id. at 1238. "'Settlement payments' are those payments made in discharge of a party's settlement obligations." Id. (citation omitted).

margin payments to brokers and settlement payments from clearing organizations, it could be said only to 'protect[ ] the ordinary course of business in the market.'" Id. However, Congress broadened § 546(e)'s protections in 1982 and expressly extended them to the securities market. Id. By so doing, Congress again sought "'to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries.'" Id. (quoting H.R. Rep. No. 97-420, at 1 (1982), as reprinted in 1982 U.S.C.C.A.N. 583, 583). The court reasoned that "[t]he danger of a 'ripple effect' on the entire market is at least as inherent in the avoidance of an LBO as it is in the avoidance of a routine stock sale." Id. Accordingly, the court concluded that the transfers made in connection with the Kaiser LBO were exempt from avoidance under § 546(e).

This court reluctantly agrees with the decisions in Kaiser I and Kaiser II and joins those courts that have adopted a broad definition of "settlement payment," In settlement of the Quality LBO, the Defendants tendered their shares to the disbursing agent, HSBC Bank, and received payment. Within the meaning of the Bankruptcy Code, those payments received by the Defendants were "settlement payments" protected under § 546(e).

The Plaintiffs' plausible argument that Congress may have intended § 546(e) to apply more narrowly—i.e., only to routine, public transactions—"is not without merit." Kaiser I, 913 F.2d at 850. As the Kaiser I court noted: "[n]either LBOs nor other exceptional transactions were even mentioned in any of the discussions of the securities industry in the reports, debates, and hearings on [§ 546(e)]." Id.

(citation omitted). Further, applying § 546(e) to Ovate securities transactions does not seem to effectuate Congress's intent of "promot[ing] stable financial markets." Official Committee of Unsecured Creditors v. Asea Brown Boveri, Inc. (In re Grand Eagle Cos.), 288 B.R. 484, 494 (Bankr. N.D. Ohio 2003). Indeed, § 546(e)'s broad protections seem to permit parties to a private securities action to circumvent potential avoidance simply by "funnel[ing] payments . . . through a financial institution." Id.

Congress could have easily addressed these concerns by narrowing or refining the language of § 546(e) or the definition in § 741(8). It has not done so. Because, in this court's opinion, application of the plain language of § 546(e) does not lead to an unjust or absurd result, this court will not impose any type of result-oriented interpretation of the language of the statute.[5] See Kaiser I, 913 F.2d at 850 (noting

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[5] During oral argument, this judge questioned one of the lead attorneys for the ESOT Defendants. Is there any principled reason to distinguish the legal treatment of the payments made to the ESOT participants from the payments made to the officers and directors who controlled the transaction? May the payments to control group participants be avoided and recovered while the ESOT Defendants are insulated from avoidance and recovery? The ESOT Defendants' attorney candidly admitted that the current law allowed no such distinction. This judge agrees. Further, all attorneys were requested to address the issue of whether § 546(e) mandates a disparate treatment between settlement payments of publicly traded securities and private securities. After much thought, this judge is unable to perceive any such legally justifiable disparate treatment under § 546(e). Although the result in Kaiser I, Kaiser II, and this adversary proceeding may seem "unfair," it is not "unjust" given the language of the Bankruptcy Code. Cf. General Elec. Capital Corp. v. Hoerner (In re Grand Valley Sport & Marine, Inc.), 143 B.R. 840, 852-53 (Bankr. W.D. Mich. 1992) (recognizing that a result may seem

that to do so would be "an act of judicial legislation"); but cf. Jewel Recovery, L.P. v. Gordon, 196 B.R. 348, 352 (N.D. Tex. 1996) (conceding that "[t]he plain language of § 546(e) would appear to apply" to private securities transactions, but holding that such application "is not consistent with the statutory scheme" of the Bankruptcy Code).

The Plaintiffs also contend that the transfers at issue were not made "by . . . a financial institution" because Quality's disbursing agent never acquired a beneficial interest in the LBO consideration. This argument was adopted by a two judge majority in Munford v. Valuation Research Corp. (In re Munford, Inc.), 98 F.3d 604 (11th Cir. 1996), cert. denied, 522 U.S. 1068, 118 S. Ct. 738 (1998).[6]

In Munford, the court assumed *arguendo* that payments to shareholders in a LBO were "settlement

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"unfair" but is "just" under existing law; general unfairness must be subservient to the justness of the statute). Current law permits transferees of an otherwise possibly avoidable fraudulent conveyance to insulate themselves from liability by using a financial institution to effectuate the settlement payment in exchange of their stock in an LBO transaction. The language in § 546(e) therefore leads to possible abuse and immunity from avoidance and recovery under constructive fraud theories. (In the event of actual fraud, there is a possible distinction; actual fraud is difficult to prove and has not been alleged in this adversary proceeding.) As a voice from the rivers and forests of Michigan, this judge hopes that Congress will reassess § 546(e).

[6] The dissenting judge disagreed with the majority's conclusion that "the dispositive issue (was) whether the financial institution acquired a beneficial interest in the settlement payments." In re Munford, 98 F.3d at 614. According to the dissent, this interpretation "disregarded the plain language of section 546(e) in order to create a new exception to its application." Id.

payments." Id. at 610. However, the court determined that the bank responsible for conveying payments to the shareholders "never acquired a beneficial interest in the funds." Id. Therefore, the bank "was not a 'transferee' in the LBO transaction." Id. Under the majority's analysis, the payments were essentially made by the debtor to the shareholders, with the bank acting as "an intermediary or conduit." Id. Because none of the entities listed in § 546(e) actually made or received a payment, the majority concluded that § 546(e) was inapplicable. Id.

Although the result may be characterized as "fair," this judge is not persuaded by the Munford analysis. By its plain language, § 546(e) applies to settlement payments made "by . . . a financial institution." In re Resorts Int'l Inc., 181 F.3d at 516. There is no requirement that the financial institution acquire "a beneficial interest in the funds they handle for the section to be applicable." Id. Again, this court will not impose policy limitations not expressly stated in the statute.

V. CONCLUSION.

Based upon statutory construction, the payments the Plaintiffs seek to avoid in this fraudulent conveyance action are "settlement payments" made by a "financial institution" under § 546(e). As such, the payments are not subject to avoidance as constructively fraudulent transfers. Therefore, the Defendants' motions for summary judgment are granted. Because the § 546(e) defense applies equally to all Defendants in this adversary proceeding, the

court shall also, on its own initiative, grant summary judgment in favor of the non-moving Defendants.[7]

A separate order shall enter accordingly.[8]

Dated this 26th day of October, 2006
at Grand Rapids, Michigan

/s/ James D. Gregg
Honorable James D. Gregg
United States Bankruptcy Judge

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[7] "[W]here one defendant succeeds in winning summary judgment on a ground common to several defendants. the [trial] court may also grant judgment to the non-moving defendants, if the plaintiff had an adequate opportunity to argue in opposition." Acequia, Inc. v. Prudential Ins. Co., 226 F.3d 798, 807 (7th Cir. 2000) (citation omitted).; see also Salehpour v. Univ. of Tenn., 159 F.3d 199, 204 (6th Cir. 1998) (quoting Celotex Corp. v. Catrett, 477 U.S. 317, 326, 106 S. Ct. 2548 (1986) (trial courts "are widely recognized to possess the power to enter summary judgments *sua sponte*, so long as the losing party was on notice that she had to come forward with all of her evidence"). The Plaintiffs have had ample opportunity to argue against application of § 546(e) in this adversary proceeding. Therefore, after careful consideration, the court concludes that summary judgment should be granted in favor of all Defendants.

[8] Bankruptcy Rule 8002(a) generally permits the filing of a notice of appeal within ten (10) days of the entry of an order. However, Bankruptcy Rule 8002(c)(2) permits a bankruptcy court to extend the time to appeal by not more than twenty (20) days. Given that an appeal is extremely likely because reasonable judges disagree about the interpretation of § 546(e), this court will, on its own initiative, extend the time to appeal to thirty (30) days after entry of the order.

APPENDIX D [1]

11 U.S.C. § 544(b). Trustee as lien creditor and as successor to certain creditors and purchasers

(b) (1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

(2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

11 U.S.C. § 546. Limitations on avoiding powers

(a) An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of—

(1) the later of—

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163,

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[1] Unless otherwise specified, all citations to title 11 of the United States Code herein do not reflect changes under Pub. L. No. 109-8, the Bankruptcy Abuse and Prevention Action of 2005, which are inapplicable in this case.

1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

(b) (1) The rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law that—

(A) permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of perfection; or

(B) provides for the maintenance or continuation of perfection of an interest in property to be effective against an entity that acquires rights in such property before the date on which action is taken to effect such maintenance or continuation.

(2) If—

(A) a law described in paragraph (1) requires seizure of such property or commencement of an action to accomplish such perfection, or maintenance or continuation of perfection of an interest in property; and

(B) such property has not been seized or such an action has not been commenced before the date of the filing of the petition;

such interest in such property shall be perfected, or perfection of such interest shall be maintained or continued, by giving notice within the time fixed by such law for such seizure or such commencement.

(c) Except as provided in subsection (d) of this section, the rights and powers of a trustee under sections 544(a), 545, 547, and 549 of this title are

subject to any statutory or common-law right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, but—

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods—

(A) before 10 days after receipt of such goods by the debtor; or

(B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor; and

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court—

(A) grants the claim of such a seller priority as a claim of a kind specified in section 503(b) of this title; or

(B) secures such claim by a lien.

(d) In the case of a seller who is a producer of grain sold to a grain storage facility, owned or operated by the debtor, in the ordinary course of such seller's business (as such terms are defined in section 557 of this title) or in the case of a United States fisherman who has caught fish sold to a fish processing facility owned or operated by the debtor in the ordinary course of such fisherman's business, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory or common law right of such producer or fisherman to reclaim such grain or fish if the debtor has received such grain or fish while insolvent, but—

(1) such producer or fisherman may not reclaim any grain or fish unless such producer or fisherman demands, in writing, reclamation of such grain or fish before ten days after receipt thereof by the debtor; and

(2) the court may deny reclamation to such a producer or fisherman with a right of reclamation that has made such a demand only if the court secures such claim by a lien.

(e) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(f) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, made by or to a repo participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(g) Notwithstanding sections 544, 545, 547, 548(a)(1)(B) and 548(b) of this title, the trustee may not avoid a transfer under a swap agreement, made by or to a swap participant, in connection with a swap agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(g)[2] Notwithstanding the rights and powers of a trustee under sections 544(a), 545, 547, 549, and 553, if the court determines on a motion by the trustee made not later than 120 days after the date of the order for relief in a case under chapter 11 of this title and after notice and a hearing, that a return is in the best interests of the estate, the debtor, with the consent of a creditor, may return goods shipped to the debtor by the creditor before the commencement of the case, and the creditor may offset the purchase price of such goods against any claim of the creditor against the debtor that arose before the commencement of the case.

11 U.S.C. § 550(a)-(b). Liability of transferee of avoided transfer

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) The trustee may not recover under section[3] (a)(2) of this section from—

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

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[2] So in original.

[3] So in original.

(2) any immediate or mediate good faith transferee of such transferee.

11 U.S.C. § 741(8). Definitions for this subchapter

In this subchapter—

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(8) "settlement payment" means a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade[.]